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IN THE

Supreme Court of the United States

October Term, 1955.
No. 244

JACOB (JAY) PALEY, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association, Executor of the Estate of Lillian Paley,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

LOYD WRIGHT,
S. EARL WRIGHT,
CLAYTON M. HURLEY,
DUDLEY K. WRIGHT,
111 West Seventh Street,
Los Angeles 14, California,
Attorneys for Petitioners.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

Jacob Paley and the Bank of America National Trust and Savings Association, a national banking association, Executor of the Estate of Lillian Paley, petitioners herein, pray that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Ninth Circuit reversing the Judgment of the Tax Court of the United States.

Opinions Below.

The opinion of the United States Court of Appeals for the Ninth Circuit is printed as Appendix A to the Petition. The opinion of the Tax Court of the United States is printed as Appendix B to the Petition and is reported in 22 T. C. 1236.

Basis of Jurisdiction.

The Judgment of the United States Court of Appeals for the Ninth Circuit was filed and entered on April 12, 1956. A Petition for Rehearing was denied by that Court without opinion on May 29, 1956. An Application for a Stay of Mandate was filed on June 4, 1956 and on said day the Mandate was ordered stayed by that Court pending the filing, consideration and disposition of this cause by this Court provided the within Petition was filed on or before July 5, 1956 and a further Stay of Mandate was granted upon application.

The jurisdiction of this Court is invoked under Section 1141 of Title 26 and Section 1254(1) of Title 28 of the United States Code.

Questions Presented for Review.

1. In the Internal Revenue Code of 1939 as Amended, did Congress intend for a partnership to apply Section 117(j) in computing its ordinary net income or its capital gains or losses pursuant to Sections 182 and 183?

2. If the answer to question 1 is yes, did Congress intend for the individual partners to ignore the partnership computation of net income or capital gains or losses in reporting their distributive share thereof in their individual returns and to aggregate their distributive share of partnership 117(j) transactions with their individual 117(j) transactions before determining whether to treat said transactions as deductions to ordinary income or as capital gains and losses pursuant to Section 117(j)?

3. In the Internal Revenue Code of 1939 as Amended, did Congress intend for a partnership to segregate Sec-

tion 117(j) items despite the fact that Section 183 provides only for the segregation of capital gains and losses and ordinary net income or loss?

Statutes Involved.

The Internal Revenue Sections which are involved in the case at bar are as follows:

Internal Revenue Code of 1939 as Amended:

Section 117(j) [As added by Sec. 151(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798 and as amended by Sec. 127(b) of the Revenue Act of 1943, c. 63, 58 Stat. 21.]

Sec. 182 [As amended by Sec. 150(g)(1)(A) of the Revenue Act of 1942 *supra*, and as amended by Sec. 150(g)(1)(B) of the Revenue Act of 1942 *supra*.]

Sec. 183 [As amended by Sec. 9(c)(1) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231.]

(26 U. S. C., 1952 Ed., Secs. 117, 182, 183.)

The provisions thereof are lengthy and for the convenience of the Court, the full text of said Internal Revenue Code sections are printed as Appendix C to this Petition.

Statement of the Case.

Petitioner, Jacob Paley during the years 1948 and 1949 owned a one-half interest in a partnership known as the "Arrowhead Partnership." During the years 1948 and 1949 said Arrowhead Partnership realized gains from the sale of the Arrowhead Springs Hotel. It was stipulated that said gains were of the nature described in Section 117(j) of the Internal Revenue Code.

In preparing its return for the years 1948 and 1949 in the same manner and on the same basis as in the case of an individual, the "Arrowhead Partnership" determined that the recognized gains upon sales or exchanges of property held in the trade or business for more than 6 months exceeded the recognized losses from such sales and considered the net gain as gain from sales or exchanges of capital assets held for more than 6 months, and included the net gain in the segregation of gains and losses from sales or exchanges of capital assets pursuant to Section 183 of the Internal Revenue Code of 1939. Petitioner Jacob Paley in the years 1948 and 1949 filed joint returns with his wife Lillian Paley and included his distributive share of the partnership capital gains in computing his net income pursuant to Section 182 of the Internal Revenue Code of 1939.

In 1948 petitioner Jacob Paley sustained a casualty fire loss. In 1949 he sustained an individual proprietorship net loss. It was stipulated below that both of these losses were of the type described in Section 117(j). For the years 1948 and 1949, Jacob Paley computed his net gain or loss from the transactions described in Section 117(j) and since in each years the gains did not exceed the losses, such gains and losses were not considered as gains or losses from sales or exchanges of capital assets but as deductions to ordinary income (*Sec. 117(j)(2) Internal Revenue Code of 1939 as Amended*).

Upon auditing the taxpayers' returns for 1948 and 1949, the Commissioner determined that deficiencies existed upon the ground that Jacob Paley's distributive share of the "Arrowhead Partnership's" 117(j) gains should be aggregated with his individual 117(j) losses prior to the application of the formula prescribed in

117(j) for the treatment of the transactions described therein despite the fact that 117(j) transactions are by definition not capital transactions and there is no provision in Section 183 of the Internal Revenue Code of 1939 for the segregation of 117(j) transactions and the resulting aggregation of said partnership transactions with like individual transactions.

The taxpayers contended that 117(j) applied to the partnership and that the determination as to whether the partnership 117(j) transactions were to be treated as a deduction to ordinary income or as capital gains or losses was to be made at the partnership level and that if the gains exceeded the losses that they were to be treated as capital gains and losses and the partner's distributive share thereof included with other capital gains and losses in his individual return. The taxpayers contended that a separate determination was to be made at the individual partner's level as to whether his individual 117(j) transactions were to receive treatment as a deduction to ordinary income or as capital gains or losses without regard to his distributive share of partnership 117(j) transactions.

On March 20, 1952 the Commissioner of Internal Revenue mailed to the taxpayers, Notice of Deficiencies in the total amount of $36,249.09. Within ninety (90) days thereafter and on May 13, 1952, the taxpayers filed a Petition with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939 as Amended. Jurisdiction was conferred upon the United States Court of Appeals for the Ninth Circuit by virtue of Section 7482 of the Internal Revenue Code of 1954.

The Tax Court ruled that petitioners' manner of reporting their income for the years 1948 and 1949 was correct.

The Ninth Circuit Court reversed the Tax Court's decision.

Reasons for Allowance of the Writ.

The decision of the United States Court of Appeals for the Ninth Circuit is in conflict with the decision of the United States Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue v. Lamont*, 156 F. 2d 800, involving substantially the same matter *i.e.*, did Congress intend in the Revenue Acts subsequent to the 1932 Act and prior to the 1954 Act, to allow partners to aggregate their distributive share of partnership transactions with their individual transactions unless such aggregation was allowed by specific legislation? Basing its decision on a review of the statutory changes in the partnership sections of the Internal Revenue Acts following the 1932 Act, the Second Circuit disallowed the offsetting of partnership capital losses against individual capital gains in computing a partner's income tax for 1937 under the Revenue Act of 1936. The Second Circuit relied upon this Court's interpretation of the legislative changes since the 1932 Revenue Act as expressed in *Neuberger v. Commissioner of Internal Revenue*, 311 U. S. 83, 61 S. Ct. 97, 85 L. Ed. 58.

Congress in the 1938 Act allowed aggregation as to capital gains or losses by providing for the segregation of partnership capital gains and losses at the partnership level (*Sec. 183, Internal Revenue Code of 1939 as Amended*), but Congress did not provide for the segregation of non-capital gains or losses of the partnership

such as are described in Section 117(j) of the Internal Revenue Code here involved.

The conflict between the *Lamont* case *supra* and the decision of the Ninth Circuit is more readily seen by comparing the converse of the factual situation in the case at bar with the facts of the *Lamont* case, *i.e.*, assume the "Arrowhead Partnership" had sustained a net loss in 117(j) transactions and hence treatment as a deduction to ordinary income at the partnership level and the partner Jacob Paley had a net gain from 117(j) transactions and hence capital gains treatment at the individual level. The same treatment should be afforded both the factual situation in the case at bar and the converse thereof.

Neuberger v. Commissioner, supra;

Mosbacher v. United States, 311 U. S. 619, 61 S. Ct. 167, 85 L. Ed. 393.

The effect of the Ninth Circuit decision is the insertion without the benefit of legislative action of the following hypothetical code section to the partnership sections of the Internal Revenue Code of 1939 as Amended:

"? ? ?—117(j) *Partnership Transactions.*

"(a) In computing the net income of the partnership, the deduction allowed by §117(j) if the net 117(j) transactions result in a loss for the year involved shall not be allowed to the partnership, but each partner shall be considered as having sustained his distributive portion of the net loss within his taxable year, which was in fact sustained by the partnership and which would be allowed to the partnership as a deduction under 117(j) if this subsection had not been enacted.

"(b) In computing the net capital gains or losses of the partnership pursuant to §183 subdivision

2(a), the treatment as capital gains of the net gains of items mentioned in §117(j) shall not be allowed to the partnership, but each partner shall be considered as having sustained his distributive portion of the net gain within his taxable year, which was in fact sustained by the partnership and which would be treated as a part of the partnership capital gains or losses if this subsection had not been enacted."

The decision involves an important question of federal income tax law. The returns of many taxpayers who participated in partnerships during the years preceding the enactment of the 1954 Revenue Code and succeeding the 1933 Amendment to the partnership sections of the Internal Revenue Act of 1932 are subject to question as a result of the opinion below. The Circuit Court's opinion is contrary to law and the clear mandate of Congress expressed in the partnership sections involved. In a field that affects every citizen, adherence to the Congressional mandate by the judiciary is necessary to preserve public confidence in our laws. This Court should exercise its power to prevent the judicial legislation here involved.

Respectfully submitted,

LOYD WRIGHT,
S. EARL WRIGHT,
CLAYTON M. HURLEY,
DUDLEY K. WRIGHT,
Attorneys for Petitioners.

APPENDIX A.

Opinion of the United States Court of Appeals.

In the United States Court of Appeals for the Ninth Circuit.

Commissioner of Internal Revenue, Petitioner, vs. Jacob (Jay) Paley and Lillian Paley, Respondents. No. 14,792. April 12, 1956.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES.

Before: Orr and Chambers, Circuit Judges, and Jertberg, District Judge.

JERTBERG, District Judge

The sole question presented by the petition for review is whether or not the computation of the taxpayers' net gains or losses under Section 117 (j) of the Internal Revenue Code of 1939, must include the taxpayers' share of partnership gains or losses under Section 117(j).

A stipulation of the parties was adopted by the Tax Court as its findings of fact. As revealed by the stipulation and the exhibits thereto, the facts material to this appeal may be summarized as follows:

Taxpayers were husband and wife. They filed joint returns for the years 1948 and 1949. During the same period the husband was associated with Joseph M. Schenck in a partnership (referred to therein as Arrowhead) which filed partnership returns for the fiscal years ending October 31, 1948 and October 31, 1949. The husband owned a 50% interest in the profits of the partnership.

In 1948 taxpayers sustained a casulty fire loss. It was stipulated that this loss was of the type described in Section 117(j) of the Internal Revenue Act; and that the correct amount of the loss was $44,420.12. In 1949 the taxpayers sustained an individual proprietorship net loss in

the amount of $106,214.98. It was stipulated that this loss, also, was of the type described in Section 117 (j).

The Arrowhead partnership sold the Arrowhead Springs Hotel prior to the tax years in question; and realized gains therefrom in 1948 and 1949. It was stipulated that these gains were of the type described in Section 117(j) of the Internal Revenue Act of 1939. It was further stipulated that the taxpayer-husband's share of these gains for 1948 was $37,675.62 and his share for 1949 was $28,333.28.

In their joint returns for 1948 and 1949, the taxpayers deducted in full their individual Section 117(j) losses in computing their net income. As for the taxpayer-husband's share of the Arrowhead partnership Section 117 (j) gains, the taxpayers took 50% of these into account as long term capital gains.

Upon auditing taxpayers' returns for 1948 and 1949, the Commissioner determined a deficiency upon the grounds, inter alia, that the taxpayer-husband's share of the Arrowhead partnership Section 117(j) gains for 1948 and 1949 should have been taken into account 100%, together with the taxpayers' individual Section 117(j) losses, in computing the single Section 117(j) net figure,

The Tax Court ruled that taxpayers' manner of reporting separately and individually their partnership Section 117(j) items was correct. The Tax Court rested its decision on the case of Jack Jordan Ammann, 22 T. C. 1106. The facts of that case are identical to the facts of this case, except that the partnership sustained the losses and the partners realized the gains, which is the converse of the instant case. The same treatment, however, should be applied to both situations.

The Tax Court in the Ammann case held that Section 117(j) (2) losses or gains of a partnership do not enter

into the Section 117(j) (2) computation of a partner. Since the petition for review was filed in this case, the decision of the Tax Court in the Ammann case was reversed by the Circuit Court of Appeals for the Fifth Circuit on December 30, 1955, and a petition for rehearing was denied on February 10, 1956.

The Fifth Circuit Court of Appeals rested its decision reversing the Tax Court, upon the decision of the Supreme Court of the United States in Neuberger vs. Commissioner, 311 U. S. 83.

The issue in the Neuberger case was whether or not a taxpayer who suffered losses from non-capital security transactions could deduct such losses when the partnership of which he was a member had gains of the same nature, and when he had no individual gains against which he could offset his losses.

The Neuberger case involved Section 23(r) of the Revenue Act of 1932, which provided that "losses from sales or exchanges of stocks and bonds * * which are not capital assets * * shall be allowed (as deductions from gross income) only to the extent of the gains from such sales or exchanges *" The taxpayer there had sustained losses of the nature described by section 23(r), in the same year that a partnership of which he was a member had realized gains of the same nature. The Supreme Court stated: "It is not to be doubted that in the enactment of Section 23 (r) (1) Congress intended not only to deal with individual security gains and losses, but also to permit losses suffered in partnership security transactions to be applied against partnership gains in like transactions. It does not follow, however, and the language of the statute does not provide, either expressly or by necessary implication, that losses sustained in an

individual capacity may not be offset against gains from identical though distinct partnership dealings. If the individual losses are actually incurred in similar transactions it cannot justly be said that the same deduction is taken a second time, or that the real purpose of the statute, which is ultimately to tax the net income of the individual partner, would thereby be impaired." Neuberger vs. Commissioner, 311 U. S. 83, 88.

Implicit in that decision was the principle that partnership income was to be computed in the same way as an individual's. Respondents contend that legislative changes since the Internal Revenue Act of 1932, and specifically the Revenue Code of 1939, have made the Neuberger decision inapplicable. In their "Additional Points and Authorities", filed following the oral argument, respondents cite the case of Commissioner of Internal Revenue vs. Lamont, 156 Fed. 2d 800, certiorari denied 329 U. S. 782. That case involved the 1936 Revenue Act, and presented the converse of the Neuberger case, namely, the offsetting of partnership losses against individual capital gains, in computing a partner's income tax for 1937, The Court stated the rationale adopted by it as follows:

"* * * That is, in short, that the elimination of Section 186 of the 1932 Revenue Act and the change in system of computing and allocating capital net losses and gains, including the specific allowance of a $2,000 deduction, render any further prohibition of a deduction unnecessary to make clear the intent of the 1934 and 1936 Acts. Under the circumstances, the inclusion of a new and more extensive negative—which is the real demand of taxpayer and the Tax Court—would have seemed a work of supererogation indeed." (Commissioner of Internal Revenue vs. Lamont, supra, page 804). In other words, the Court found in the Lamont case, that Congress

had prohibited the offsetting of the losses claimed. Admittedly, the case under review is controlled by the Internal Revenue Act of 1938, and we find nothing in the legislative changes in the 1934 and 1936 Revenue Acts which indicate a Congressional intent to support the respondents' contention.

Section 183 of the Internal Revenue Code of 1939 provides that the net income of a partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c) and (d). Subsection (b) (1) provides that there shall be segregated the gains and losses from sales or exchanges of capital assets. Section 182 provides that in computing the net income of each partner, he shall include, whether or not distribution is made to him, as a part of his gains and losses from sales or exchanges of capital assets held for not more than six months, and for more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months and for more than six months, and (c) "his distributive share of the ordinary net income or the ordinary net losses of the partnership computed as provided in Section 183 (b)." Respondents argue that if Congress had intended partnership Section 117(j) gains and losses to be segregated and carried over into the individual returns of the partners, and there combined with the partners' other Section 117(j) gains and losses, Congress would have amended Section 183(b) in the Revenue Act of 1942, when Section 117(j) was enacted, to provide that Section 117(j) gains and losses, as well as capital gains and losses, be segregated.

Section 117(j) was enacted to permit the taxpayer to receive capital gain treatment on his net gains under Sec-

tion 117(j), in order to preclude hardship. Congress had the taxpayer in mind, and not the partnership, which is not a taxpayer. It is an accounting unit. The taxpayer's distributive share of partnership gains and losses under Section 117(j) must be included in computing his net gains or losses of that nature, if the intent of Congress is to be accomplished. The underlying concept of Section 181 is that the partners are the taxpayers. It is the partners collectively who realize directly partnership gains and sustain directly the partnership losses.

The fact that Congress, by Section 183, requires segregation of capital gains and losses, and net income or losses, in computation of partnership income, does not exclude the segregation and the resulting aggregation between the partnership and the individual partners of all other items. To adopt such a view would ascribe to Congress the intent that a taxpayer should benefit twice from Section 117(j) in the same year, receiving capital gain treatment as to his share of partnership gains and at the same time benefit from the deduction in full of his individual losses of the same nature. We find nothing to indicate that Congress intended such an inequitable and unsound application of Section 117(j).

The maxim, "expressio unius est exclusio alterius" was rejected under analogous situations by the Supreme Court in the Neuberger case, and in the case of Jennings vs. Commissioner, 110 Federal 2d 945, certiorari denied 311 U.S. 704. We reject it in this case.

The decision of the Tax Court must, therefore, be reversed, and the case remanded for entry of judgment in favor of the Commissioner.

(Endorsed:) Opinion. Filed Apr. 12, 1956.
Paul P. O'Brien, Clerk.

APPENDIX B.

22 T. C. No. 153

THE TAX COURT OF THE UNITED STATES.

Jacob (Jay) Paley and Lillian Paley, Petitioners, v. Commissioner of Internal Revenue, Respondent. Docket No. 40898. Filed September 21, 1954.

Section 117(j)(2), I. R. C. 1939—Partnership Gain and Individual Loss.—Partnership long-term gains from non-capital assets were long-term capital gains under section 117(j) in computing the distributable shares of the partnership income, and a partner's share of such gains does not offset his long-term losses from individually owned non-capital assets under section 117(j)(2).

S. EARL WRIGHT, ESQ., for the petitioners.

GEORGE E. COSTABLE, ESQ., for the respondent.

OPINION.

Murdock, *Judge:* The Commissioner determined deficiencies in income tax of the petitioners of $16,042.31 for 1948 and $20,206.78 for 1949. The only issue for decision is whether the individual section 117(j) (Internal Revenue Code of 1939) losses of the taxpayer-partner are to be offset by his share of section 117(j) gains of the partnership. The stipulation of the parties is adopted as the findings of fact.

The petitioners, husband and wife, filed joint returns for the years 1948 and 1949 with the collector of internal revenue for the Southern District of California.

The petitioners, individually, sustained losses of "the type described under section 117(j)" of $44,420.12 in 1948 and $106,214.98 in 1949. The petitioners deducted the full amount of these losses on their returns for the taxable years.

Jacob was a member of a partnership which realized gains of "the type described under section 117(j)" during the taxable years. Jacob's shares of these gains were $37,675.62 for the year 1948 and $28,333.28 for the year 1949. The petitioners reported these amounts as long-term capital gains on their returns for the taxable years.

The Commissioner, in determining the deficiencies, held that the petitioners' section 117(j) losses had to be offset against Jacob's shares of the partnership section 117(j) gains. The petitioners contend that Jacob's shares of the section 117(j) gains of the partnership should be reported as long-term capital gains on their joint returns and should not be used to offset their individual section 117(j) losses. The taxpayer in the recent case of Jack Jordan Ammann, 22 T.C....., (August 26, 1954) had long-term capital gains from individually owned non-captial assets, while a partnership of which he was a member had long-term losses from non-capital assets. It was there held that a computation had to be made for the partnership under section 117(j)(2) after which the individual partner reported his distributive share of the net income of the partnership and that the section 117(j) losses of the partnership were not to be carried over as if they were section 117(j)(2) losses of the individual partner and offset against his section 117(j) gains. The facts here are different in that here the partnership had the gain while the individual had the losses but the principle is the same, the section 117(j)(2) losses or gains of the partnership do not enter into the section 117(j)(2) computation for the partner, and upon authority of that case the issue is decided for the petitioners.

Decision will be entered under Rule 50.

APPENDIX C.

Statute and Regulations Involved.

INTERNAL REVENUE CODE OF 1939:

Section 117(a) Definitions.—As used in this chapter.

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23 (1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or before March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(2) Short-term Capital Gain.—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than six (6) months, if and to the extent such gain is taken into account in computing net income;

(3) Short-term Capital Loss.—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than six (6) months, if and to the extent such loss is taken into account in computing net income;

(4) Long-term Capital Gain.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than six (6) months, if and to the extent such gain is taken into account in computing net income;

(5) Long-term Capital Loss.—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than six (6) months, if and to the extent such loss is taken into account in computing net income;

(6) Net Short-term Capital Gain.—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) Net Short-term Capital Loss.—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) Net Long-term Capital Gain.—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) Net Long-term Capital Loss.—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(10) Net Capital Gain.—

(A) Corporations.—In the case of corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges; and

(B) Other Taxpayers.—In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets. If the tax is to be computed under Supplement T, "net income" as used in this paragraph shall be read as "adjusted gross income."

(11) Net Capital Loss.—The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the sum allowed under subsection (d). For the purpose of determining losses under this paragraph, amounts which are short-term capital losses under subsection (e) (1) shall be excluded.

(b) Percentage Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss and net income:

100 per centum if the capital asset has been held for not more than six (6) months;

50 per centum if the capital asset has been held for more than six (6) months.

* * * * * * * *

Section 117(j) Gains and Losses from Inventory Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.—

(1) Definition of Property Used in the Trade or Business.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), held for more than six (6) months, and real property used in the trade or business, held for more than six (6) months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) General Rule.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, of an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than six (6) months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six (6) months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described

therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than six (6) months shall be considered losses from a compulsory or involuntary conversion.

Section 182. In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than six (6) months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than six (6) months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six (6) months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in Section 183 (b).

Section 183. (a) General Rule.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) Segregation of Items.—

(1) Capital Gains and Losses.—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) Ordinary Net Income or Loss.—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) Charitable Contributions.—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by Section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

(d) Standard Deduction.—The standard deduction provided in section 23 (aa) shall not be allowed.

No. 244

No. 14792

Office - Supreme Court, U.
FILED
JUL 9 1956
JOHN T. FEY, Clerk

United States
Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

JACOB (JAY) PALEY and LILLIAN PALEY,
Respondents.

Transcript of Record

Petition to Review a Decision of The Tax Court of the United States

FILED
NOV 10 1955
PAUL P. O'BRIEN, CLERK

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif. —10-21-55

No. 14792

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Court of Appeals
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

H. BRIAN HOLLAND,
Assistant Attorney General,

ELLIS N. SLACK,
Special Assistant to Attorney General,
Tax Division, Department of Justice,
Washington, D. C.,

Counsel for Petitioner.

WRIGHT, WRIGHT, GREEN & WRIGHT,
S. EARL WRIGHT,
111 West Seventh Street,
Los Angeles 14, California,

Counsel for Respondents.

The Tax Court of the United States

Docket No. 40898

JACOB (JAY) PALEY and LILLIAN PALEY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES

For Petitioner: S. Earl Wright, Esq., J. R. White, Esq.

For Respondent: George Constable, Esq.

8/26/54—Transferred to Judge Murdock.

DOCKET ENTRIES

1952

May 13—Petition received and filed. Taxpayer notified. Fee paid.

May 14—Copy of petition served on General Counsel.

July 8—Answer filed by General Counsel.

July 8—Request for hearing in Los Angeles, filed by General Counsel.

July 11—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

1953

Jan. 8—Hearing set February 24, 1953, Los Angeles, California.

1953

Mar. 3—Hearing had before Judge Turner on the merits. Stipulation of Facts with exhibits 1-A through 4-D filed, Briefs due 5/4/53; Replies due 6/18/53.

Mar. 24—Transcript of Hearing 3/3/53 filed.

Apr. 29—Motion for extension to 6/5/53 to file brief, filed by General Counsel. 5/1/53—Granted.

May 4—Brief filed by taxpayer.

Jun. 4—Motion for extension to June 19, 1953, to file opening brief, filed by General Counsel. 6/5/53—Granted.

Jun. 19—Brief filed by General Counsel.

Jun. 22—Copy of brief served on General Counsel.

July 6—Reply brief filed by Taxpayer. Copy served.

July 28—Motion for extension to Sept. 11, 1953 to file reply brief, filed by General Counsel. 7/31/53—Granted.

Sep. 11—Reply Brief filed by General Counsel. Served 9/14/53.

1954

Sep. 21—Opinion filed, Judge Murdock, Decision will be entered under Rule 50, 9/21/54—Copy served.

1955

Jan. 4—Agreed computation filed.

Jan. 10—Decision entered, Judge Murdock, Div. 12.

Apr. 1—Petition for Review by U. S. Court of Appeals for the Ninth Circuit filed by General Counsel.

Apr. 11—Proof of Service filed (S. Earl Wright).

1955

Apr. 11—Proof of Service filed (Jacob (Jay) Paley and Lillian Paley).

Apr. 28—Motion for extension of time to June 30, 1955 for filing the record and docketing the appeal filed by General Counsel.

Apr. 29—Order extending time to June 30, 1955, for filing the record and docketing the appeal, entered.

Jun. 3—Statement of Points with statement of service by mail thereon filed by General Counsel.

Jun. 3—Statement re diminution of record with statement of service by mail thereon filed by General Counsel.

[Title of Tax Court and Cause.]

PETITION

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency LA:IT:90D:CTF, dated March 20, 1952, and as a basis for their proceeding, allege as follows:

(1) The petitioners are individuals residing at 1060 Brooklawn Drive, Los Angeles 24, California. The returns for the periods here involved were filed with the Collector of the Southern District of California.

(2) The Notice of Deficiency (a copy of which is attached hereto and marked Exhibit "A") was mailed to the petitioners on March 20, 1952.

(3) The taxes in controversy are:

(a) Income taxes for the calendar year 1948 in the amount of Sixteen thousand forty-two and 31/100 Dollars ($16,042.31).

(b) Income taxes for the calendar year 1949 in the amount of Twenty thousand two hundred six and 78/100 Dollars ($20,206.78), less the amount thereof as may total any deficiency occasioned by the amounts of Seven hundred fifty Dollars ($750.00) and Five hundred forty-three and 95/100 Dollars ($543.95) in item (a) and by items (b) and (c) of the Agent's statement of adjustments to net income for the calendar year 1949, with respect to which no issue is raised herein.

(4) The determination of the taxes set forth in the Notice of Deficiency with respect to which this petition for redetermination relates is based upon the following errors:

(a) With respect to the taxes for the year 1948:

(i) Income increased by Eighteen thousand eight hundred thirty-seven and 81/100 Dollars ($18,837.81) under Sec. 117 (j) I.R.C. by the adjustment of gains or losses by carrying over the Jay Paley and Joseph M. Schenck partnership capital gains and applying such gains to taxpayer's 117 (j) losses.

(b) With respect to the taxes for the year 1949:

(i) Income increased by Fourteen thousand one hundred sixty-six and 64/100 Dollars ($14,166.64) under Sec. 117 (j) I.R.C. by the adjustment of gains or losses by carrying over of the Jay Paley and Joseph M. Schenck partnership capital gains and applying such gains to taxpayers' 117 (j) losses.

(c) The erroneous holding that the capital asset which produced the income for the years in question was an asset held or used in a trade or business under the provisions of 117 (j) I.R.C.

(d) The disregard by the Commissioner of the provisions of 183 I.R.C. which requires each partner taxpayer to account only for his share of the partnership net income computed in the manner therein required.

(e) It is unlawful and erroneous for the Commissioner to combine or offset co-partnership gains or losses under the provisions of Sec. 117 I.R.C. with the petitioners' individual gains or losses under Sec. 117 (j) I.R.C.

(5) The facts upon which the petitioners rely as a basis of this proceeding are as follows:

Between November, 1941, and October, 1946, Jay Paley and Joseph M. Schenck, as co-partners, owned the Arrowhead Springs Hotel. The hotel was at all times during that period in the possession of the United States Government or lessees of the owners. The owners did not at any time operate the hotel. Their co-partnership venture was at all times confined to the business of ownership until

the hotel was sold in 1946 at a substantial paper profit, which has been and is being reported on an installment basis.

The owners have filed all partnership information tax returns required by law to be filed. The partnership income has been computed in the manner required by law, and partner Jay Paley has included, whether or not distributed to him, his share of the partnership net income required by law to be included in a co-partner's income tax return. This was done for the years in question and for all prior years during the existence of said partnership.

Taxpayer Jacob (Jay) Paley engaged in other trades or business in which he benefited from gains and in which he suffered from losses, but all of which were taken into account in computing taxpayers' net income for tax purposes. Taxpayers maintained books of account and records, in which all of their business transactions are recorded. During the tax years in question, some of such gains or losses resulted from involuntary conversions and from the sale or exchange of property used in such trade or business. None of such gains or losses directly or indirectly related to nor were any of them connected with the profits reported by said partnership.

In determining taxable net income, the gains or losses from taxpayers' trades or business were computed pursuant to Sec. 117 (j) I.R.C., and reported on taxpayers' returns. Taxpayers contend that these

items have been correctly reported on their tax returns.

Furthermore, the individual partners prepared and filed their partnership return of income under the provisions of Sec. 183 I.R.C. All requirements as to the showing of capital gains separately and contributions were met. The excess of the income over deductions was shown as ordinary income as required therein. There is no provision of law known to taxpayers which requires the showing of 117 (j) gains separately in said partnership returns.

Wherefore the petitioners pray that this Court may hear the proceedings and determine that the Commissioner is in error in assessing deficiency income taxes against petitioners for the years 1948 and 1949 by carrying over the gains and losses of the Jay Paley and Joseph M. Schenck partnership under the provisions of 117 (j) I.R.C. and applying such gains to taxpayers' 117 (j) losses; and that petitioners have such further relief as is just and equitable in the premises.

/s/ JACOB PALEY
/s/ LILLIAN PALEY

/s/ S. EARL WRIGHT,
of Wright, Wright, Green & Wright,
Attorneys for Petitioners
/s/ J. R. WHITE,
of Price, Waterhouse & Co.

Duly Verified.

EXHIBIT "A"

U. S. Treasury Department, Office of Internal Revenue Agent in Charge, Subway Terminal Bldg., 417 South Hill St., Los Angeles, 13, Calif.

Internal Revenue Service Mar. 20, 1952
LA:IT:90D:CTF

Mr. Jacob (Jay) Paley and Mrs. Lillian Paley
Husband and Wife
1060 Brooklawn Drive, Los Angeles 24, Calif.

Dear Mr. and Mrs. Paley:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1948 and 1949 discloses a deficiency of $36,249.09, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward

it to this office for the attention of LA:CONF. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

JOHN B. DUNLAP,
Commissioner,

/s/ By GEORGE D. MARTIN,
Internal Revenue Agent in Charge

CTF:vmc

Enclosures: Statement, Form 1276, Agreement Form

Statement

Tax Liability for the Taxable Years Ended December 31, 1948 and 1949

Year		Deficiency
1948	Income Tax	$16,042.31
1949	Income Tax	20,206.78
	Total	$36,249.09

In making this determination of your income tax liability careful consideration has been given to the report of examination dated March 16, 1951, to your protest dated May 8, 1951, and to the statements made at the conferences held.

A copy of this letter and statement has been mailed to your representative, Mr. S. Earl Wright, 111 West Seventh Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1948

Net income as disclosed by return		$108,661.19
Additional income and unallowable deductions:		
(a) Section 117(j), I.R.C., income increased	21,663.61	
(b) Interest deduction disallowed	10,290.00	
(c) Expenses allocable to non-taxable income disallowed	1,572.69	
(d) Loss from Jaclyn Stable decreased	2,630.32	
Net income adjusted		$144,817.81

EXPLANATION OF ADJUSTMENTS

(a) It is held that the following transactions shall be treated as gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business under the provisions of section 117(j) of the Internal Revenue Code. It is determined that the gains do not exceed the losses; therefore, none of such gains and losses are treated as gains and losses from the sales or exchange of capital assets as computed below:

Losses:		
Sale of race horse—"Anecdote"		$ 11,693.54
Fire in personal residence—January 30, 1948	44,420.12	
Total		$ 56,113.66
Gains:		
From Jay Paley (Jacob Paley) and Joseph M. Schenck partnership	$37,675.62	
Sale of Cadillac automobile	2,000.00	
Total		$ 39,675.62
Amount not subject to the limitations of section 117 (b) nor of section 117(d) of the Internal Revenue Code		$ 16,438.04

The adjustment to your income is determined as shown below:

Section 117(j), I.R.C., asset	Gain (Loss) Reported*	Gain (Loss) Corrected	Increase (Decrease) to Income
Race horse—"Anecdote"	($ 6,250.00)	($ 11,693.54)	($ 5,443.54)
Casualty loss	(52,683.62)	(44,420.12)	8,263.50
Jay Paley (Jacob Paley) and Joseph M. Schenck partnership gains (your distributive share)	19,831.97	37,675.62	17,843.65
Cadillac automobile	1,000.00	2,000.00	1,000.00
		Net increase	$21,663.61

* Amounts taken into consideration in return.

(b), (c), and (d) You have previously indicated your agreement to these adjustments and the tax resulting therefrom has been assessed.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1948

Net income adjusted		$144,817.81
Less: Excess of net long-term capital gain over net short-term capital loss		1,742.92
Ordinary net income		$143,074.89
Less: Exemptions		1,800.00
Balance, subject to surtax and normal tax		$141,274.89
One-half of $141,274.89		$ 70,637.44
Tentative surtax	$40,517.21	
Tentative normal tax at 3% ($2,119.12 less $15.15*)	2,103.97	
Total	$42,621.18	
Less reduction under Sec. 12(c), I.R.C.	5,134.54	
Partial tax on one-half of net income		$ 37,486.64
Combined partial tax ($37,486.64 x 2)		$ 74,973.28
Plus: 50 per cent of $1,742.92		871.46
Combined alternative tax		$ 75,844.74

* Credit for partially tax-exempt interest.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1948

Net income adjusted		$144,817.81
Less: Exemptions		1,800.00
Balance, subject to surtax and normal tax		$143,017.81
One-half of $143,017.81		$ 71,508.91
Tentative surtax	$41,196.95	
Tentative normal tax at 3% ($2,145.27 less $15.15)	2,130.12	
Total	$43,327.07	
Less reduction under Sec. 12(c), I.R.C.	5,219.25	
Total normal tax and surtax on one-half of net income		$ 38,107.82
Combined normal tax and surtax ($38,107.82 x 2)		$ 76,215.64
Combined alternative tax		$ 75,844.74
Less: Income tax paid to a foreign country		375.00
Correct income tax liability		$ 75,469.74
Income tax liability shown on return, account No. 9129580	$48,927.74	
Plus: Amount assessed 11/4/49, Acct. No. 519034	2,888.47	
Amount assessed 6/8/50, Acct. No. 6—510166	7,611.22	59,427.43
Deficiency of income tax		$ 16,042.31

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1949

Net income as disclosed by return		$ 89,785.14
Additional income and unallowable deductions:		
(a) Section 117(j), I.R.C., income increased		15,460.59
(b) Interest deduction disallowed		10,290.00
(c) Miscellaneous deductions decreased		5,533.72
Total		$121,069.45
Decrease in income and additional deductions:		
(d) Contributions increased	$ 2,311.56	
(e) Dividends decreased	50.20	2,361.76
Net income adjusted		$118,707.69

EXPLANATION OF ADJUSTMENTS

(a) It is held that the following transactions shall be treated as gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business under the provisions of section 117(j) of the Internal Revenue Code. It is determined that the gains do not exceed the losses; therefore, none of such gains and losses are treated as gains and losses from the sale or exchange of capital assets as computed below:

Losses:		
Sale of race horses		$106,214.98
Gains:		
Sale of Cadillac automobile	$ 1,500.00	
From Jaclyn Stables partnership	1,087.90	
From Jay Paley (Jacob Paley) and Joseph M. Schenck partnership	28,333.28	
Total		30,921.18
Amount not subject to limitations of section 117(b) nor of section 117(d) of the Internal Revenue Code		$ 75,293.80

The adjustment to your income is determined as shown below:

Section 117(j), I.R.C., asset	Gain (Loss) Reported*	Gain (Loss) Corrected	Increase (Decrease) to Income
Race horses	($106,214.98)	($106,214.98)	$ .....
Cadillac automobile	750.00	1,500.00	750.00
Jaclyn Stable race horse	543.95	1,087.90	543.95
Jay Paley (Jacob Paley) and Joseph M. Schenck partnership gains (your distributive share)	14,166.64	28,333.28	14,166.64
		Total increase	$15,460.59

* Amounts taken into consideration in your return.

(b) The deduction claimed for interest in the amount of $10,290.00 and designated "Jacqueline Paley Trust" has been determined to be an unallowable deduction.

(c) Miscellaneous deductions claimed in the total amount of $35,055.27 have been determined to be unallowable to the extent of $5,533.72, as shown below:

Automobile expenses decreased (personal expenses disallowed)	$ 2,732.05
Travel and entertainment expenses decreased (personal expenses disallowed)	1,933.56
Commissions on non-taxable interest disallowed	119.60
Expenses allocable to non-taxable income disallowed	748.52
Total	$ 5,533.72

(d) You are allowed an additional deduction of $2,311.56 for contributions under section 23(o), I.R.C., computed as shown below:

(Total contributions as shown by your return $18,908.20)

Contributions allowed as a deduction (15% of $220.-912.80, adjusted gross income corrected)	$ 33,136.92
Amount claimed as a deduction in your return	30,825.36
Additional deductions	$ 2,311.56

(e) The income reported from dividends is decreased in the amount of $50.20, representing an increase over the amount claimed as the non-taxable portion of Anaconda Copper Mining Co. dividend.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1949

Net income adjusted		$118,707.69
Less: Excess of net long-term capital gain over net short-term capital loss		1,131.24
Ordinary net income		$117,576.45
Less: Exemptions		1,800.00
Balance, subject to surtax and normal tax		$115,776.45
One-half of $115,776.45		$ 57,888.22
Tentative surtax	$30,999.52	
Tentative normal tax at 3% ($1,736.64 less $2.47*)	1,734.17	
Total	$32,733.69	
Less reduction under Sec. 12(c) I.R.C.	3,948.04	

Partial tax on one-half of net income	$ 28,785.65
Combined partial tax ($28,785.65 x 2)	$ 57,571.30
Plus: 50 per cent of $1,131.24	565.62
Combined alternative tax	$ 58,136.92

* Credit for partially tax-exempt interest.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1949

Net income adjusted		$118,707.69
Less: Exemptions		1,800.00
Balance, subject to surtax and normal tax		$116,907.69
One-half of $116,907.69		$ 58,453.84
Tentative surtax	$31,406.76	
Tentative normal tax at 3% ($1,753.62 less $2.47)	1,751.15	
Total	$33,157.91	
Less reduction under Sec. 12(c), I.R.C.	3,998.95	
Total normal tax and surtax on one-half of net income		$ 29,158.96
Combined normal tax and surtax ($29,158.96 x 2)		$ 58,317.92
Combined alternative tax		$ 58,136.92
Less: Income tax paid to a foreign country		412.50
Correct income tax liability		$ 57,724.42
Income tax liability shown on return, account No. 3202335		37,517.64
Deficiency of income tax		$ 20,206.78

[Endorsed]: T.C.U.S. Filed May 13, 1952.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayers, admits and denies as follows:

(1), (2) and (3). Admits the allegations contained in paragraphs (1), (2) and (3) of the petition.

(4) (a) to (e) inclusive. Denies the allegations of error contained in subparagraphs (a) to (e) inclusive, of paragraph (4) of the petition.

(5) For lack of sufficient information upon which to form an opinion as to the truth or accuracy of the allegations contained in paragraph (5) of the petition herein, the same are denied.

(6) Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES W. DAVIS,
Chief Counsel, Bureau of Internal Revenue

Of Counsel:
B. H. Neblett, District Counsel.
E. C. Crouter, Clayton J. Burrell, Special Attorneys, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed July 8, 1952.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, by the respective counsel, that the facts hereinafter stated shall be taken as true:

1. The Petitioners are individuals residing at 1060 Brooklawn Drive, Los Angeles 24, California.

2. Hereafter, the use of the word "petitioners" denotes Jacob (Jay) Paley and Lillian Paley, and the use of the word "petitioner" denotes Jacob (Jay) Paley.

3. All issues as set out in the notice of deficiency dated March 20, 1952, are hereby conceded by the petitioners for the years 1948 and 1949, except as set out below in paragraphs 13 and 19.

4. The petitioners filed a joint individual income tax return for the year 1948, a copy of which, marked Exhibit 1-A, is attached hereto and made a part hereof.

5. The petitioners filed a joint individual income tax return for the year 1949, a copy of which, marked Exhibit 2-B, is attached hereto and made a part hereof.

6. The petitioner Jacob (Jay) Paley filed a partnership return for the fiscal year ending October 31, 1948 in the name of Jay Paley (Jacob Paley) and Joseph M. Schenck, a copy of which, marked Exhibit 3-C, is attached hereto and made a part hereof.

7. The petitioner Jacob (Jay) Paley filed a partnership return for the fiscal year ending October 31, 1949 in the name of Jay Paley (Jacob Paley) and Joseph M. Schenck, a copy of which, marked Exhibit 4-D, is attached hereto and made a part hereof.

8. Hereafter, the use of the words "Arrowhead partnership" denotes that partnership described on the October 31, 1948 and 1949 partnership returns (Exhibits 3-C and 4-D) as Jay Paley (Jacob Paley) and Joseph M. Schenck. The petitioner held a 50 per cent interest in the profits of this partnership from November 1, 1947 to December 31, 1949.

9. The petitioners reported $52,683.62 as casualty fire loss in 1948 (Exhibit 1-A, pg. T.C. 15 and 21). The respondent determined that this loss should be corrected to $44,420.12 (Deficiency Notice—Statement pg. 2). The petitioners accept the respondent's determination. This loss of $44,420.12 was the type described under Sec. 117(j), I.R.C., and 100 per cent thereof was included in net income.

10. The petitioners reported $16,324.89, for the taxable year 1948, as a net gain from the sale or exchange of capital assets (Exhibit 1-A, pg. T.C. 2 and 10). The $16,324.89 consists of $15,577.81 as the husband's gains (Exhibit 1-A, pg. T.C. 12), and $747.51 as the wife's gains (Exhibit 1-A, pg. T.C. 11).

11. The respondent determined that the petitioners' 50 per cent share of the gain for 1948 from sale of the Arrowhead Springs Hotel was $37,675.62 (Deficiency Notice—Statement pg. 2). The

petitioner agrees with this determination. The Arrowhead partnership return indicates that the amount, before the above correction, was $39,663.95 (Exhibit 3-C, pg. T.C. 3). This gain of $37,675.62 was the type described under Sec. 117(j), I.R.C.

12. The petitioners included 50 per cent of the $39,663.95 gain, referred to in paragraph 11, in net income for 1948. 50 per cent of $39,663.95 was included in the $16,324.89 referred to in paragraph 10 (Exhibit 1-A, pg. T.C. 12).

13. The petitioners contend that the $37,675.62 gain, referred to in paragraph 11, should be included in the petitioners' 1948 income tax return as a long-term capital gain at 50 per cent of $37,675.62. The respondent contends that 100 per cent of the $37,675.62 gain should be included in the computation of Sec. 117(j), I.R.C., net gains or losses.

14. The petitioners reported $106,214.98, for the taxable year 1949, as a net loss from the sale or exchange of property other than capital assets (Exhibit 2-B, pg. T.C. 2, 12 and 14). This net loss was the type described under Sec. 117(j), I.R.C., and 100 per cent thereof was included in net income.

15. The Jay Paley Stables (Exhibit 2-B, pg. T.C. 14) was an individual proprietorship owned by the petitioners, and the $106,214.98 net loss, referred to in paragraph 14, was an individual proprietorship net loss incurred by Jay Paley Stables.

16. The petitioners reported $16,591.83, for the taxable year 1949, as a net gain from the sale or exchange of capital assets. (Exhibit 2-B, pg. T.C. 2, 12 and 13).

17. The Arrowhead partnership, for the fiscal year ended October 31, 1949, received $56,666.55 as gain on the sale of Arrowhead Springs Hotel (Exhibit 4-D, pg. T.C. 3). The petitioners' 50 per cent share of this gain was $28,333.28. This gain was the type described under Sec. 117(j), I.R.C.

18. The petitioners included 50 per cent of the $28,333.28 gain, referred to in paragraph 17, in net income for 1949. 50 per cent of $28,333.28 was included in the $16,591.83, referred to in paragraph 10 (Exhibit 2-B, pg. T.C. 13).

19. The petitioners contend that the $28,333.28 gain, referred to in paragraph 18, is properly included in the petitioners' 1949 income tax return as a long-term capital gain at 50 per cent of $28,333.28 as was done on the 1949 return. The respondent contends that 100 per cent of the $28,333.28 should have been included in the computation of Sec. 117(j), I.R.C., net gains or losses.

/s/ S. EARL WRIGHT,
Counsel for Petitioners

/s/ CHARLES W. DAVIS,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent

[Endorsed]: T.C.U.S. Filed March 3, 1953.

[Title of Tax Court and Cause.]

OPINION

Filed September 21, 1954.

Section 117(j)(2), I.R.C. 1939—Partnership Gain and Individual Loss.—Partnership long-term gains from non-capital assets were long-term capital gains under section 117(j) in computing the distributable shares of the partnership income, and a partner's share of such gains does not offset his long-term losses from individually owned non-capital assets under section 117(j)(2).

S. Earl Wright, Esq., for the petitioners.
George E. Constable, Esq., for the respondent.

Murdock, Judge: The Commissioner determined deficiencies in income tax of the petitioners of $16,042.31 for 1948 and $20,206.78 for 1949. The only issue for decision is whether the individual section 117(j) (Internal Revenue Code of 1939) losses of the taxpayer-partner are to be offset by his share of section 117(j) gains of the partnership. The stipulation of the parties is adopted as the findings of fact.

The petitioners, husband and wife, filed joint returns for the years 1948 and 1949 with the collector of internal revenue for the Southern District of California.

The petitioners, individually, sustained losses of "the type described under section 117(j)" of $44,420.12 in 1948 and $106,214.98 in 1949. The peti-

tioners deducted the full amount of these losses on their returns for the taxable years.

Jacob was a member of a partnership which realized gains of "the type described under section 117(j)" during the taxable years. Jacob's shares of these gains were $37,675.62 for the year 1948 and $28,333.28 for the year 1949. The petitioners reported these amounts as long-term capital gains on their returns for the taxable years.

The Commissioner, in determining the deficiencies, held that the petitioners' section 117(j) losses had to be offset against Jacob's shares of the partnership section 117(j) gains. The petitioners contend that Jacob's shares of the section 117(j) gains of the partnership should be reported as long-term capital gains on their joint returns and should not be used to offset their individual section 117(j) losses. The taxpayer in the recent case of Jack Jordan Ammann, 22 T.C. —, (August 26, 1954) had long-term capital gains from individually owned non-capital assets, while a partnership of which he was a member had long-term losses from non-capital assets. It was there held that a computation had to be made for the partnership under section 117 (j)(2) after which the individual partner reported his distributive share of the net income of the partnership and that the section 117(j) losses of the partnership were not to be carried over as if they were section 117(j)(2) losses of the individual partner and offset against his section 117(j) gains. The facts here are different in that here the partnership had the gain while the individual had the

losses but the principle is the same, the section 117(j)(2) losses or gains of the partnership do not enter into the section 117(j)(2) computation for the partner, and upon authority of that case the issue is decided for the petitioners.

Decision will be entered under Rule 50.

The Tax Court of the United States
Washington

Docket No. 40898

JACOB (JAY) PALEY and LILLIAN PALEY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

The parties filed an agreed computation on January 4, 1955, pursuant to the Court's Opinion filed September 21, 1954. Therefore, it is

Ordered and Decided, that there is no deficiency in income tax for the year 1948 and a deficiency in income tax in the amount of $10,268.04 for the year 1949.

[Seal] /s/ J. E. MURDOCK,
Judge

Entered January 10, 1955.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 40898

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

JACOB (JAY) PALEY and LILLIAN PALEY,
Respondents on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on January 10, 1955, ordering and deciding that there is no deficiency in income tax for the year 1948 and a deficiency in income tax in the amount of $10,268.04 for the year 1949. This petition for review is filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

The respondents on review (hereinafter referred to as the taxpayers), are husband and wife, residing at 1060 Brooklawn Drive, Los Angeles 24, California. They filed joint individual income tax returns for the calendar years 1948 and 1949 with the Collector of Internal Revenue for the Sixth District of California, located at Los Angeles, Cali-

fornia, and within the judicial circuit of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The issue is whether the taxpayers, husband and wife, under Section 117(j), Internal Revenue Code of 1939, must offset their individual Section 117(j) losses by the husband's share of his Section 117(j) partnership gains. The taxpayers incurred individual 117(j) losses in 1948 and 1949. The husband, Jacob Paley, realized 117(j) partnership gains during these two taxable years. The Commissioner held that the taxpayers' individual 117(j) losses had to be offset against Jacob Paley's share of 117(j) partnership gains. The taxpayers contended that Jacob Paley's share of 117(j) partnership gains should be reported as long-term capital gains on their joint returns and should not be used to offset their individual 117(j) losses. The Tax Court, however, decided the issue for the taxpayers and held that the husband's share of his Section 117(j) partnership gains does not offset the taxpayers' individual 117(j) losses.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General

/s/ R. P. HERTZOG,
Acting Chief Counsel, Internal Revenue Service

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT OF POINTS

Comes Now the petitioner on review herein and makes this concise statement of points on which he intends to rely on the review herein, to-wit:

The Tax Court of the United States erred:

1. In holding that a partner's distributive share of his partnership's long-term capital gains under Section 117(j) of the Internal Revenue Code of 1939 does not offset his individual ordinary losses under Section 117(j).

2. In failing to uphold the position of the Commissioner that the taxpayers' individual Section 117(j) losses had to be offset against husband taxpayer's share of Section 117(j) partnership gains.

3. In holding that there is no deficiency in income tax for the year 1948 and a deficiency in income tax in the amount of $10,268.04 for the year 1949.

4. In failing to hold that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $16,042.31 and $20,206.78, respectively.

5. In that its opinion and decision are contrary to law and regulations.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service
Attorneys for Petitioner on Review

Statement of Service attached.

[Endorsed]: T.C.U.S. Filed June 3, 1955.

[Title of U. S. Court of Appeals and Cause.]

STATEMENT RE DIMINUTION OF RECORD

To the Clerk of The Tax Court of the United States:

Pursuant to the provisions of Rule 75(o) of the Federal Rules of Civil Procedure adopted by the United States Court of Appeals for the Ninth Circuit, you are hereby notified that the petitioner on review will not exclude or omit any part of the record in this proceeding.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service
Attorneys for Petitioner on Review

Statement of Service attached.

[Endorsed]: T.C.U.S. Filed June 3, 1955.

The Tax Court of the United States
Washington

[Title of Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 26, inclusive, constitute and are all of the original papers and proceedings, including exhibits 1-A through 4-D attached to the Stipulation of Facts, on file in my office as called for by the "Statement Re Diminution of Record" in the proceeding before The Tax Court of the United States entitled: "Jacob (Jay) Paley and Lillian Paley, Petitioners, vs. Commissioner of Internal Revenue, Respondent, Docket No. 40898," and in which the Respondent in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 8th day of June, 1955.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States

[Endorsed]: No. 14792. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Jacob (Jay) Paley and Lillian Paley, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: June 21, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14792

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

JACOB (JAY) PALEY and LILLIAN PALEY,
Respondents.

STATEMENT OF POINTS AN DESIGNATION OF RECORD FOR PRINTING

Pursuant to this Court's Rule 17.6, the Commissioner of Internal Revenue herewith states the points on which he intends to rely and designates those portions of the record which he deems material to this appeal.

As his statement of points the Commissioner hereby adopts the Statement of Points filed on his

behalf in the Tax Court on June 3, 1955, and transmitted to this Court as Document No. 25 of the record on appeal. This statement bears an appropriate certificate of service upon counsel for respondents dated June 3, 1955.

The Commissioner hereby designates the following portions of the record for printing as material to this appeal:

Docket Entries.

Petition.

Answer.

Stipulation of Facts, omitting the attached Exhibits 1-A through 4-D.

Opinion.

Decision.

Petition for Review.

Statement of Points.

Statement re Diminution of Record.

Certificate and Seal.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General,
Counsel for Petitioner

[Endorsed]: Filed Jun. 24, 1955. Paul P. O'Brien, Clerk.

Office - Supreme Court, U.S.
FILED

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 244

JACOB (JAY) PALEY and BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association, Executor of the Estate of Lillian Paley, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. 7-8) is reported at 22 T.C. 1236. The opinion of the Court of Appeals (Pet. App. 1-6) is reported at 232 F. 2d 915.

JURISDICTION

The judgment of the Court of Appeals was entered on April 12, 1956 (Pet. App. 6), and a timely petition for rehearing was denied on May 29, 1956 (R. 42). The petition for a writ of certiorari was filed on July 9, 1956. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the computation of a taxpayer's net gain or loss under Section 117(j) of the Internal Revenue Code of 1939 must include the taxpayer's share of partnership gains or losses under Section 117(j).

STATUTE INVOLVED

Sections 117(b), (d), and (j), 181, 182, 183(a) and (b), and 187 of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp. 7-11.

STATEMENT

A stipulaton of the parties (R. 19-22) was adopted by the Tax Court as its findings of fact (R. 23). The material facts may be summarized as follows:

Taxpayers were husband and wife. They filed joint returns for the years 1948 and 1949. (R. 19.) During the same period the husband was associated with Joseph M. Schenck in a partnership (referred to herein as Arrowhead) which filed partnership returns for the fiscal years ended October 31, 1948, and 1949. The husband held a 50 per cent interest in the profits of the partnership. (R. 19-20.)

In 1948 taxpayers sustained a casualty fire loss of the type described under Section 117(j) in the amount of $44,420.12. In 1949 the taxpayers sustained an individual proprietorship net loss in the amount of $106,214.98; this loss was also of the type described under Section 117(j). (R. 20-21.)

The Arrowhead partnership sold the Arrowhead Springs Hotel prior to the tax years in question; and realized gains therefrom in 1948 and 1949. These gains were of the type described under Section 117(j); the

taxpayer-husband's share thereof for 1948 was $37,675.62, and his share for 1949 was $28,333.28. (R. 20-22.)

In their joint returns for 1948 and 1949, taxpayers deducted in full their individual Section 117(j) losses, in computing their net income. As for the taxpayer-husband's shares of the Arrowhead partnership's Section 117(j) gains, the taxpayers took 50 per cent of these into account as long-term capital gain. (R. 20-22.)

Upon auditing taxpayers' returns for 1948 and 1949, the Commissioner determined deficiencies upon the ground, *inter alia*, that the taxpayer-husband's shares of the Arrowhead partnership Section 117(j) gains for 1948 and 1949 should have been taken into account 100 per cent, together with taxpayers' individual Section 117(j) losses, in computing a single Section 117(j) net figure. (R. 21-22.)

The Tax Court ruled, however, that taxpayers' manner of reporting separately their individual and partnership Section 117(j) items was correct. On appeal, the court below reversed and remanded the case to the Tax Court for entry of judgment in favor of the Commissioner. (R. 23-25, 40.)

ARGUMENT

1. The Court of Appeals held that where (a) a partnership of which the taxpayer was a member realized gains of the type described under Section 117(j) of the Internal Revenue Code of 1939 (Appendix, *infra*, pp. 8-9), (b) these gains were reported as long-term capital gains, and (c) at the

same time the taxpayer sustained individual Section 117(j) losses, such losses had to be offset against his share of the partnership gains in order to determine whether there was a net capital gain or a net loss deductible as an ordinary loss. This holding is in accord with the decision of this Court in the analogous cases of *Neuberger* v. *Commissioner,* 311 U.S. 83, and *Mosbacher* v. *United States,* 311 U.S. 619. It is also in accord with the recent decision of the Fifth Circuit in *Commissioner* v. *Ammann,* 228 F. 2d 417 (decided on the authority of the *Neuberger* decision), which involved the identical issue, although arising in a different factual setting.

It is clear from the partnership provisions of the 1939 Code (Sections 181, 182, and 183 (Appendix, *infra,* pp. 9-11)) that a partnership has no independent status taxwise save for limited accounting purposes, and that the individual partners are the taxpayers who realize the partnership gains and sustain the partnership losses. It necessarily follows that partnership items retain their identity in the hands of the partners, despite the requirement of Section 183 that partnership capital items be segregated in computing partnership income. Accordingly, in applying the provisions of Section 117(j), which requires that a taxpayer take into account all of his gains and losses of a given nature in reaching a net figure, his individual gains or losses and his distributive share of the partnership gains or losses must be offset one against the other. To hold otherwise would, as the court below pointed out (Pet. App. 6), enable a taxpayer to benefit twice in the same year from Section

117(j) by receiving capital gain treatment as to his share of the partnership gains and at the same time receive the benefit of the deduction in full of his individual losses of the same nature. There is no indication, as the court found, that Congress intended such an "inequitable and unsound application of Section 117(j)."

2. There is no conflict between the decision below and that of the Second Circuit in *Commissioner* v. *Lamont*, 156 F. 2d 800, certiorari denied, 329 U.S. 782. That case arose under the Revenue Act of 1936, while the *Ammann* case and the instant case arose under the provisions of Section 117(j) of the 1939 Code. As the court below pointed out (Pet. App. 4-5), the Second Circuit found in the *Lamont* case, after a consideration of the legislative history and the provisions of the several Revenue Acts involved, that Congress had prohibited the offsetting of the losses claimed by virtue of the limitations of Section 117(d) of the Revenue Act of 1936, c. 690, 49 Stat. 1648.[1] No such limitation was in effect with respect to the taxable years involved herein. Subparagraph (A) of Section 117(j)(2) expressly provides that, for the purposes thereof, subsection 117(d) shall not apply in determining whether gains exceed losses. In view of the difference in the applicable statutory provisions, the alleged conflict does not exist.

---

[1] That section provided as follows:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

CONCLUSION

The decision below is correct, and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

OSCAR H. DAVIS,
Acting Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

A. F. PRESCOTT,
GEORGE F. LYNCH,
Attorneys.

AUGUST, 1956

APPENDIX

Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(b) [as amended by Section 150(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(d) [as amended by Section 150(c) of the Revenue Act of 1942, *supra*, and Section 8(d)(2) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(2) *Other taxpayers.*—In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer or $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from

sales or exchanges of capital assets. If the tax is to be computed under Supplement T, "net income" as used in this paragraph shall be read as "adjusted gross income".

* * * * *

(j) [as added by Section 151(b) of the Revenue Act of 1942, *supra*, and as amended by Section 127(b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence

thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sale or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1952 ed., Sec. 181.)

SEC. 182 [as amended by Section 150(g)(1) of the Revenue Act of 1942, *supra*]. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1952 ed., Sec. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) [as amended by Section 9(c)(1) of the Individual Income Tax Act of 1944, *supra*] *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) [as amended by Section 150(g)(2)(A) of the Revenue Act of 1942, *supra*] *Segregation of Items.*—

(1) *Capital gains and losses.*—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) *Ordinary net income or loss.*—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 183.)

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.
(26 U.S.C. 1952 ed., Sec. 187.)

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